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Rocket Mining Corporation, A Utah Corporation, and Pioneer Carissa Gold Mines, Inc., A Wyoming Corporation v. Bulan J. Gill and Angelo M. Billis : Plaintiff, Respondent and Appellants Brief

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THE SUPREME COURT
OF THE STATE OF UTAH

ROCKET MINING CORPORATION
a Utah corporation, and
PIONEER CARISSA GOLD
MINES, INC., a Wyoming
corporation,
Plaintiffs, Respondents and Cross-Appellants,

— vs. —

ULAN J. GILL, LENORE M. GILL,
RAY GILL, ANGELO M. BILLIS,
HERMAN F. LUND and
T. W. BILLIS,
Defendants, Appellants and Respondents.

Case
No. 10467

Plaintiff, Respondent and Cross-Appellants Brief

APPEAL FROM THE JUDGMENT OF THE
THIRD DISTRICT COURT FOR
SALT LAKE COUNTY
HONORABLE ALDON J. ANDERSON, *Judge*

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IN THE SUPREME COURT OF THE STATE OF UTAH

ROCKET MINING CORPORATION, a Utah corporation, and PIONEER CARISSA GOLD MINES, INC., a Wyoming corporation,
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STATEMENT OF THE KIND OF CASE

This is an action brought by the plaintiff corporation against the promoters, officers and directors of Rocket Mining Corporation to recover salaries unlawfully paid to some of the officers and directors and to recover the proceeds from the sale of the corporate assets which were distributed to the officers and directors of Rocket Mining Corporation. The plaintiffs claim with reference to the salaries paid is based upon the theories (a) that the payment of salaries and compensation was in violation of an agreement made by the corporation and the defendant-directors for the benefit of the stockholders of Rocket Mining Corporation at the time the corporation registered its stock with the Securities Department of the State of Utah and with the Securities and Exchange Commission of the United States, and (b) that the voting of salaries to the defendants, Rulan J. Gill and Angelo M. Bills, and the payment of said salaries in the amount of $17,400.00 was authorized pursuant to a resolution passed at a meeting illegally called, which meeting was not attended by a quorum of directors.

The claim with reference to the sale of the corporate assets and the distribution to the promoters and directors of the proceeds from such sale is based upon the theories (a) that such action constituted a violation of the directors' fiduciary duty to the corporation and its stockholders and constituted a corporate fraud, and (b) that the resolution authorizing the sale of the corporate assets and the payment of the proceeds from such sale to the directors and promoters was passed at a meeting which was not attended by a quorum of disinterested directors and it was, therefore, void.

The plaintiffs have also asked for an accounting from the directors of their handling of the corporate funds and properties.

DISPOSITION IN LOWER COURT

In the lower court the plaintiffs moved for summary judgment as to Count 1 of the First Cause of Action for the salaries unlawfully paid and as to Count 3 as it pertains to the sale of the corporate properties for $130,000.00 and the distribution of the proceeds to the promoters and directors. The lower court granted the motion as to Count 1 of the First Cause of Action but denied the motion as to Count 3 of the First Cause of Action. The court granted judgment against Gill and Billis for the exact amount of the salaries each received instead of granting a judgment against them jointly and severally for the total amount paid out to them by the corporation. The trial court limited the basis for the judgment to the theory that the payment of salaries was in violation of an express agreement made for the benefit of the stockholders that the defendants would not take salaries until the mining operations of the corporation were on a paying basis.

RELIEF SOUGHT ON APPEAL

The respondents in their cross-appeal seek to have the judgment of the trial court modified and judgment entered jointly and severally against the defendants for the total amount of the salaries paid and interest thereon and for summary judgment on Count 3 of the First Cause of Action for the proceeds which the defendants paid to themselves resulting from the sale of the corporate interest in the Rim Group of claims for $130,000.00.

STATEMENT OF FACTS

Respondents cannot agree that the statement of facts presented in appellants' brief is accurate. Such statement contains many irrelevancies and facts which were not established for purposes of the motion for summary judgment.

Appellants introduce their statement of facts by reference to a "rather strange interlude in Utah history," i. e. the uranium boom, apparently on the theory that no holds were barred during this period of time and that corporate frauds should be countenanced and the over-reaching of officers and directors in such companies should be excused. The respondents will attempt to limit the statement of facts to the admitted relevant facts which the respondents believe entitled them to judgment as a matter of law against the defendants on both the First and Third Counts of the First Cause of Action.

The following facts were established and were the basis upon which the plaintiffs' motion for summary judgment was presented to the lower court.

1. On July 14, 1955, the Rocket Mining Corporation filed applications to register securities for sale to the public with the Securities and Exchange Commission and with the Securities Commission of the State of Utah. On August 10, 1955, the board of directors passed a resolution as follows:

> "1. That the terms and conditions set forth by the Securities Commission of Utah be ac

cepted and that said terms and conditions be set forth in the minutes of this meeting." See page 6 of minute book. (Ex. P. 2)

Paragraph No. 8 of the terms and conditions accepted at this meeting (page 8 of minute book, Ex. P. 2) provides that a copy of the proposed prospectus will be filed with the Commission subject to approval by the Commission and that a copy of the prospectus will be given to each purchaser of stock.

Paragraph No. 14 of said terms and conditions (page 8 of minute book, Ex. P. 2) provides that the corporation will mail three copies of its prospectus to each dealer involved in the sale of the corporate securities.

2. The prospectus (Ex. P. 3) approved by the Securities Commission and made a part of the registration statement (Ex. P. 1) filed with the Securities and Exchange Commission has the following agreement and representation at pages 5 and 6.

> "No salaries or other compensation shall be paid directly or indirectly to officers, directors or promoters of Issuer, other than secretary-treasurer, who will receive $75.00 per month, until Issuer's mining operations are on a paying basis."

3. The mining operations of Rocket Mining Corporation were never on a paying basis. R. J. Gill, president of the corporation, testified on November 3, 1961, at the taking of his deposition as follows:

> "Question: At the time you disbursed this $130,000.00 the corporation had no revenue at all,

did it? Answer: *Well, it never did have any revenue to speak of.*" (page 26, lines 27-29. Deposition of R. J. Gill, November 3, 1961.) (Emphasis added)

R. J. Gill on January 19, 1965, again testified that the mining operations of the corporation were never on a paying basis as follows:

> "Question: So all of the properties, so far as any operating revenue were concerned, were net losses with the exception of this Rim Group of claims that were sold, isn't that right? Answer: Well, I think that is right, yes." (Page 48, lines 27-30. Deposition of R. J. Gill, January 19, 1965.)

Prior to this statement on the part of Gill, Mr. Gill was examined as to each property and testified that none of the mining operations produced any net profit and the only gross revenues were a nominal amount received from operations on the White Horse Claims which the company had to abandon because the lease on the claims was invalid and which revenue was simply credited to monies that Rocket owed in connection with exploration work performed on those claims and a small amount received on some oil leases which amount was credited to sums owed by Rocket for the drilling of these properties. The corporate ledger reflects only one item of revenue from the mining properties (Ex. P. 8, Account No. 301) in the amount of $773.72, which sum Mr. Gill testified was not even received by the company but was simply credited to corporate debt owed in connection with the operation of the properties, which debt was considerably in excess of the gross receipt.

4. The corporation sold 3,000,000 shares of its securities pursuant to the authority from the Securities and Exchange Commission and the Securities Commission of the State of Utah based on the prospectus containing the agreement and representation referred to in Paragraph No. 2 above.

5. At the annual stockholders' meeting held July 17, 1956, (page 41 of minute book, Ex. P. 2) the stockholders voted to establish a board of seven directors. The stockholders elected four persons to the board of directors and left three vacancies to be filled by the board members.

6. At a special directors' meeting held December 14, 1956 (page 58 of minute book, Ex. P. 2) the following directors were present and voted to pay to A. M. Billis a monthly salary of $700.00 commencing January 1, 1957, and a salary to R. J. Gill of $750.00 commencing January 1, 1957, R. J. Gill, Lenore Gill, his wife; Ray Gill, father of R. J. Gill, and Walter Pesseto.

7. Pursuant to the resolution purportedly passed on December 14, 1956, the corporation paid to R. J. Gill and A. M. Billis $17,400.00 in salaries.

8. At a special stockholders' meeting held February 27, 1957, (pages 65-67 of minute book, Ex. P. 2) the articles of incorporation of Rocket Mining Corporation were amended to provide for a board of seven directors.

9. On December 26, 1957, a special directors' meeting was held pursuant to a waiver of notice. This waiver

of notice was signed only by three directors, R. J. Gill, Lenore Gill, his wife, and T. W. Billis, the brother of A. M. Billis (page 81 of minute book, Ex. P. 2). At the special meeting the only directors present were R. J. Gill, Lenore Gill, his wife; Ray Gill, father of R. J. Gill, and T. W. Billis, the brother of A. M. Billis. The vacancies existing had not been filled and the board was operating with fewer directors than the minimum of seven required by the articles of incorporation. (See amendment to articles of incorporation introduced in evidence, Ex. P. 7). At this meeting the directors present resolved to sell the corporation's interest in the Rim Group of claims for $130,000.00 and to divide the proceeds principally among themselves. (See pages 83 and 84 of minute book, Ex. 2.)

10. On January 14, 1958, the corporation received a certifiied check drawn against the trustee account of Keller & Blumenthal, attorneys at law, Denver, Colorado, in the amount of $130,000.00 in payment for the corporate interest in the Rim Group of claims. On the same day the check was cashed at the Bank of Lander and cashiers' checks were obtained, made payable in the manner purportedly authorized by the meeting of December 26, 1957. (See photostatic copies of cashiers' checks introduced in evidence, Ex. P. 9.) Only $4,661.66 of the above amount was paid to the company.

ARGUMENT

POINT I.

THE TRIAL COURT PROPERLY GRANTED THE PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT FOR THE AMOUNT OF THE SALARIES AND INTEREST ON SUCH AMOUNTS WHICH WERE PAID TO THE DEFENDANTS, ANGELO M. BILLIS AND RULAN J. GILL. THE COURT ERRED, HOWEVER, IN FAILING TO MAKE THE JUDGMENT JOINT AND SEVERAL AGAINST ALL OF THE DEFENDANT-DIRECTORS.

POINT I-A

THE PURPORTED AUTHORIZATION TO THE PROMOTERS AND PRINCIPAL OFFICERS, RULAN J. GILL AND ANGELO M. BILLIS, VIOLATED THE AGREEMENT MADE WITH THE SECURITIES COMMISSION AND THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, WHICH AGREEMENT RAN TO THE BENEFIT OF THE STOCKHOLDERS AND THIS PAYMENT OF SALARIES CONSTITUTED A CORPORATE FRAUD WHICH ENTITLED THE CORPORATION TO RECOVER ALL SUMS PAID, TOGETHER WITH INTEREST.

As pointed out in the statement of facts recited above, the officers and directors entered into an agreement with the Securities and Exchange Commission of the United States and with the Securities Commission of the State of Utah to the effect that no salaries or other compensation should be paid directly or indirectly to officers, directors or promoters of the issuer except that the secretary-treasurer would receive $75.00 per month until such time as the issuer's mining operations were on a paying basis. (See p. 8 of minute book, Ex. P. 2; Registration Statement, Ex. P. 3, and Offering Circular, pp. 5 and 6, Ex. P. 3.) The corporation then sold 3,000,000 shares of the common capital stock of the company based upon the promise and representation that no salaries would be paid directly or indirectly. Appellants at page 5 of their brief correctly state that the purpose of the agreement incorporated in the offering circular was to "allay investors' fears that officers might use the moneys received by the company as a result of the public stock sale for corporate salaries rather than a development of the company interests:" We concede that this is one of the principal purposes of such an agreement and that it was a very material contract running to the benefit of all of the shareholders of the corporation. The promoters had every reason to agree to serve the corporation without compensation because they were the controlling stockholders and had the most to gain by any increase in the value of the shares. As a matter of fact the defendants admit that after they terminated the public offering of the corporate stock, purportedly because it was not selling, they sold very substantial amounts of their personal stock on the public markets at substantial profits to themselves. (See Answers to Interrogatories, R. 47 and 48.) In *Korn* v. *Coburn Credit Co.*, 154 N.Y.S.2d

No. 27, p. 9, the court held that a failure to disclose the existance of an employment contract constituted a fraud on the public purchasing stock and was an absolute defense to a suit to recover unpaid salary. The court in that case, in denying the right of the plaintiff to recover his unpaid salaries, said:

> "The plaintiff as a member of the board was duty bound to make such disclosure. His failure to do so constituted a fraud on the public and a violation of law imposing criminal sanctions, and he cannot reap benefits from his own wrong doing. The motion is granted, and the complaint dismissed without leave to replead."

The corporation and its stockholders are third party beneficiaries to any agreement made by the defendants as officers, directors and promoters of the company that they would act for the company without salary until the mining properties were on a paying basis. The Utah Supreme Court has even gone so far as to hold that a corporation not yet in existance becomes a third party beneficiary to an agreement between subscribers to purchase stock in the corporation when it is formed and achieves a corporate existance. *Utah Hotel Company* v. *Madsen*, 10 U. 285, 134 P. 37. Further, the agreement and representation that no salaries would be paid was an integral part of the offer made to the stockholders to sell them stock in the corporation and the payment of such salaries after having made the representation that none would be paid was a breach of this agreement and of their fiduciary duty to the corporation unless the mining properties of the corporation were on a paying basis. That the properties were never on a paying basis is undisputed. See Statement of Admitted Facts above, Paragraph No. 3. The term "on a paying basis" has been held to mean net profits from operations. In *Nelson v. Steele*, 130 P. 886 a similar fact situation was involved. There a contract provided that the contract could be cancelled at the option of the parties should the corporation "not be on a paying basis within one year from date." The plaintiff sued to cancel the contract, claiming that the corporation was not on a paying basis within the year. The court held that the words "paying basis" were the equivalent of net profits from operations. It is clear in this case that what was contemplated in the prospectus and in the registration statement by the covenant not to pay any salaries until the mining properties were on a paying basis was that salaries would only be paid out of net profits from the operation of the company properties or to put it another way, since the mining properties were of a speculative nature and the promoters were raising money for the purpose of mining ore from the properties, they would not spend any money to line the pockets of the promoters unless and until the mining properties were successfully operating and producing net revenue. This event did not occur.

Appellants protest that this agreement was intended to "eliminate a prospective buyer's concern that paid-in capital might be dissipated in officers' salaries." (Appellant's brief, p. 10.) Appellants' contention that such a provision should be strictly construed because it amounts to a forfeiture is preposterous. There is no forfeiture here involved. The simple truth of the matter is that the promoters of the company who occupied a position of control as majority stockholders made an express agreement with the corporation and with the governmental bodies for the benefit of the stockholders who might purchase stock in the corporation that they would serve the corporation without salaries until such time as the mining properties were operating on a paying basis. The argument that the corporation accepted the service of the defendants and can, therefore, not sue to recover the illegal salaries paid because they cannot restore to the defendants the services rendered and, thus, meet the requirements of an action to rescind is likewise without any legal basis because it was expressly agreed that they would serve the corporation for nothing and they had every reason to so agree because the position of majority stockholders that they occupied in the corporation.

POINT 1-B

THE MEETING AT WHICH THE SALARIES WERE VOTED WAS A NULLITY BECAUSE THERE WAS NO QUORUM PRESENT.

The payment of these salaries was not only in violation of the express agreement and of the representations made in the offering circular which induced the stockholders to buy their stock but the purported directors' meeting which authorized the payment of the illegal salaries was a nullity. The stockholders on July

17, 1956, (page 41 of minute book) established a board consisting of seven directors. No valid meeting could have been held without seven disinterested directors being present.

> "In the absence of provision to the contrary in the statute, charter or by-laws, a majority of the entire board of directors is necessary, and is sufficient, to constitute a quorum, and to transact business. Less than a majority cannot meet and bind the corporation by any act or resolution, unless expressly authorized, even though there is a vacancy on the board. All they can do is to adjourn. * * * A director who is disqualified by reason of personal interest in the matter before a directors' meeting loses, pro hac vice, his capacity as a director and he cannot be counted for the purpose of making out a quorum. * * * His vote, in other words, is a mere nullity." Ballentine — Law of Corporations, Sec. 45, pp. 130-131.

It is well settled that a director cannot act for the corporation in a matter in which he has an adverse interest and according to the great weight of authority he cannot be counted in determining whether or not a quorum exists to consider the matter of business even though he does not vote on the particular matter of business. 13 Am. Jur Corp. Sec. 960, p. 919. In *Hotaling v. Hotaling,* 224 P. 455 (Calif.) the court in considering whether or not a deed to property executed by a corporation was void analyzed the rule as to the determination of whether a quorum exists. In that case the board of directors consisted of five members. Three of the board was present at the meeting and one of the members present had an interest in the transaction adverse to the corporation. The court in holding that the transaction was void stated:

> "Being personally interested in this transaction adversely to the corporation he was disqualified thereby to vote the authorization, *and his presence could not be counted to make a quorum for that purpose.*"

> "At directors' meetings, the percentage requirement for a quorum is ordinarily tested against the total number of directors authorized to constitute a full board, regardless of vacancies." Corporate Rule and Practice, Hornstein, Sec. 415, p. 513.

> "A director with an adverse interest in a transaction to be voted upon will not be counted toward a quorum unless the statute or charter or by-laws expressly provide the contrary. This general rule conforms to and implements the principal that an interested director may not vote." Corporate Rule and Practice, Hornstein, Sec. 415, p. 514. (Emphasis supplied)

At the meeting authorizing the salaries (page 57 of minute book) it is recited that A. M. Billis resigned as a director. This left four directors of a board of seven. There can be no question that R. J. Gill was directly interested in the salary resolution, as was his wife, Lenore Gill. This would leave, at best, only Ray Gill, the father of R. J. Gill, and Walter Pesseto, the brother-in-law of A. M. Billis, as distinterested directors and, hence, a quorum of directors was not present to authorize the salaries.

All of the directors assenting to the payment of the unlawful salaries are joint and severally liable even though they themselves did not receive any benefits from the unlawfully paid salaries. *Sorin* v. *Shahmoon Industries, Inc.*, 220 N.Y.S. 2nd 60, p. 778.

The appellants argue at page 11 of their brief that the proceeds from the sale of the corporation's mining properties should be construed as profits from the mining operation and, therefore, when such profits were realized the accrued salaries of the officers could lawfully be paid. While we cannot see how the sale of the corporate property could possibly be interpreted as a mining operation being conducted on a paying basis as argued under Point I(b) at page 11 of the appellants' brief, if we were to accept this theory it still would not entitle the appellants to accrue an obligation for salaries during a period when there was no revenue from operations of the mining properties, or otherwise, and then pay the accrued salaries from the proceeds of the sale of capital assets which is precisely what the defendants caused to be done in this instance. The cases cited under Paragraph I(b) at page 11 purportedly holding that officers have a duty to sell corporate property when necessary to save the corporation from bankruptcy are not applicable here. In this instance the salaries paid were paid unlawfully and there was no valid claim against the corporation for salaries which could have been enforced by the defendants against the corporation. The officers and directors by their own acts created a fictitious debt which was unenforceable and they paid this purported debt by liquidating the principal corporate asset. Even if the sale of this capital asset can be considered as creating a profitable mining operation then and only then could the board of directors authorize the commencement of salaries to the defendants and thus the arguments contained under Point I(b) and (c) have no merit. All of the salaries paid were accrued substantially before the sale of the capital assets which the defendants contend created a profitable mining operation as a result.

Under Point I(d) defendant-appellants argue that equity and public policy required the payment of salaries since the defendants were responsible for profits to the corporation. In the case cited (*Cominetti* v. *Prudence Mutual Life Insuranme Assn.*, 62 CA 2d 945, 146 P. 2d 15) the court simply held that where valuable services are rendered it is presumed that the intent of the parties was to compensate for said services. This case, however, has no application to the existing case because in the instant case there was an express agreement in which the defendant-appellants pledged themselves to serve the corporation gratuitously until such a time as the mining operations were on a paying basis. There can be no implied agreement to pay salaries or compensation where there is an existing express agreement not to pay salaries or compensation.

Under Point II of appellants' brief, pages 16 and 17, the appellants indulge in the curious argument that since the corporation itself paid the salaries the corporation is not in a position to recover the salaries back and further, that it cannot be shown that the salaries were actually paid out of the monies raised from the public offering and, hence, the plaintiff has suffered no damage. The appellants also point out that this is not a derivitive action and that while the stockholders buying stock may have been damaged by the breach of the agreement not to pay salaries the corporation cannot so object.

The right of any action in a derivative law suit belongs to a corporation and is brought on the theory that the corporation itself refuses to bring said action and, therefore, the stockholder is entitled to bring the action derivatively. In this case the corporation itself is bringing the action. The argument that the corporation permitted itself to be swindled by the officers and directors and, therefore, has no right to complain is unique and consistent with the statement of facts in appellants' brief, page 3, relating to that "strange interlude in Utah history" where the spirit of Robinhood prevailed and corporate treasuries were fair game for every prowling band of promoters.

Appellants argue under Point II of their brief, page 17, that the corporation is estopped to assert the defense that the payment of salaries was ultra vires and that in order to rescind the corporation must be in a position to return the services rendered by the defendant-appellants in order that they will be restored to the position they were prior to their performance of the employment contract. The only difficulty with this argument is that the defendant-appellants had an express agreement with the corporation, its stockholders and the governmental agencies authorizing the sale of the corporation stock that they would not make any employment contract with the corporation until the mining operations of the corporation were on a paying basis. Furthermore, the resolution purporting to create an employment agreement was a totally invalid resolution because there was not even a quorum of directors present to resolve anything.

POINT II.

THE SALE OF THE RIM GROUP OF CLAIMS AND THE DISTRIBUTION OF THE PROCEEDS TO THE PROMOTERS AND DIRECTORS WAS UNAUTHORIZED AND CONSTITUTED A FRAUD ON THE CORPORATION, AND THE TRIAL COURT SHOULD HAVE GRANTED SUMMARY JUDGMENT AGAINST THE DEFENDANTS FOR THE PROCEEDS REALIZED FROM THE SALE OF THE RIM GROUP OF CLAIMS.

On December 26, 1957, a purported directors' meeting was held to authorize the sale of the corporation's interests in the Rim Group of claims for $130,000.00. The meeting was held pursuant to a waiver of notice by only three directors, R. J. Gill, Lenore Gill and T. W. Billis. (Page 81 of minute book, Ex. P. 2) At the time of this meeting the stockholders had amended the articles of incorporation to provide for a minimum board of seven directors. It is elementary that when the number of directors by reason of vacancies, fall below the minimum required by the articles of incorporation there is no board and no business can be conducted.

> "Where, however, the charter or articles of association provide that the business of the corporation shall be conducted by 'not less than five directors and not more than seven,' it has been decided that where the number of the directors is reduced by death and other causes below the number of five, the directors cease to have power to act for the corporation." 13 Am. Jur. 960, a page 918.

Not only was the purported resolution wholly void by reason of the directors purporting to act with less than the minimum required by the articles of incorporation but it was void for two additional reasons: 1. That the waiver of notice was not signed by all of the directors, and 2. That of the directors present, R. J. Gill, Lenore Gill, Ray Gill and T. W. Billis, only Ray Gill, the father of R. J. Gill, and T. W. Billis could be in any way considered to be a disinterested director. R. J. Gill was to receive a total of $42,604.13 and his wife, Lenore Gill, had a direct interest in seeing him receive this money. This would leave as possible disinterested directors only Ray Gill, the father of R. J. Gill, and T. W. Billis, the brother of A. M. Billis. So, if we count disinterested noses by giving the benefit of any doubts to the defendants there were only two disinterested directors of a minimum board of seven present to vote on the disbursement of the $130,000.00.

> "Since a director cannot act for the corporation as such in matters in which he has an adverse

> interest, a director present when the directors attempt to take action upon a matter in which he is adversely interested or otherwise disqualified cannot, according to what seems the better view, be counted to make a necessary quorum, even though he does not vote upon the matter. * * * A director of a corporation cannot form one of a quorum necessary to convey corporate property to himself. As a corollary, if a director of a corporation necessary to constitute a quorum is interested in the proceedings, the corporate act is void. 13 Am. Jur Sec. 960, p. 919.

The action of the directors of the company in voting to liquidate one of the principal assets of the corporation and to pay the alleged indebtedness to themselves is contrary to fundamental corporate law.

> "Upon similar principle, the directors have no authority to use the funds of the corporation to pay their individual indebtedness. The rule that an agent cannot use the property of his principle to pay his own debt applies to all agents of every grade. A director of a corporation is no more exempt from this rule than the humblest agent in its service. * * * Since the property of a corporation is a trust fund in the hands of the directors for the benefit of its creditors and stockholders, an agreement by which the property of the corporation is disposed of for their own use and benefit will not be upheld against the creditors and stockholders who do not assent thereto." 13 Am. Jur. Sec. 962, p. 922. See also, Textile Mills v. Colpack, 264 Ala. 669, 89 S. 2d 187.

A director or officer of a corporation is a fiduciary and owes the highest duty to the stockholders of the corporation and to the corporation whose proprietors business he manages. He has no right to dispose of corporate assets for the primary purpose of paying a claim which he has against the corporation unless by virtue of stockholder action or at least by resolution of a disinterested quorum of directors. A director has the same duty that a trustee has to his Cestui Que Trust. In ... *man* v. *Miller*, 101 F. 2d 85, the court defined this duty as follows:

> "A director of a corporation occupies a fiduciary relation to it and its stockholders. This position is one of trust and he is frequently nominated a trustee and so held accountable in equity. The ordinary trust relationship of directors of a corporation and stockholders is not a matter of statutory or technical law. It springs from the fact that directors have the control and guidance of corporate business affairs and property and hence the property interests of the stockholders. Equity recognizes that stockholders are the proprietors of the corporate interests and are ultimately the only beneficiaries thereof."

In *Modern Corporation Law* by Oleck, Vol. 2, S. 959, the author defines the duties of a director as follows:

> "Directors, as the central power of management, stand in a fiduciary capacity to the ... of shareholders and their economic interests ... Ingrained in this fiduciary relationship are ... important touchstones of conduct to which Equity holds directors in their management of corporate affairs. These criteria are: (1) the highest loyalty to the interests of the corporation; (2) at least reasonable care and business prudence ... directors must not act for their own ...

benefit, but must act solely for the benefit of the shareholders of the corporation." p. 730.

The author goes on to stated:

"* * * all profits made by directors through [illegible] dealings involving the transaction of corporate affairs or which involve a conflict of personal interest and fidelity to the interests of the company must be accounted for by the directors to the company." p. 731.

In the case of *Camden Land Company v. Lewis*, 63 Atl. 523, the board of directors consisting of three members including the president, W. D. Lewis, met and voted Mr. Lewis a salary and an expense account. This meeting was attended only by the president and one other director. Mr. Lewis subsequently drew part of the money which he contended was owed to him as salary and expenses and invested the same in a farm. He also took stock of the corporation in part payment for his services which was sold and the proceeds invested in the farm. A stockholder brought suit to impress a constructive trust upon the farm to the extent of the funds invested by Lewis in the farm. The court impressed the constructive trust upon the farm and ordered the farm sold to the [illegible] of the investment made with the monies improperly [illegible] from the corporation for the reason that the resolution authorizing the salary and expense account was not passed by a quorum of disinterested directors, there being only one disinterested director voting of a quorum of three directors. In connection with the ruling the court said:

"It is well settled that an officer cannot apply corporate property in his possession to the payment of a debt due to himself from the corporation, without the authority of the directors, and the corporation may require a return of the property thus appropriated. * * * No more, we think can an officer pay himself with treasury stock without the authority of the directors. While it is true that the president and general manager of a corporation sometimes exercises quite extensive powers in the executive management of its business, he is, nevertheless, acting all the time under the express or implied authority of the directors, who are the real managers of the corporation. He has no implied authority to sell treasury stock. * * * And, in the absence of any vote of the directors (and there is none in this case) authorizing the president of the corporation to have issued to himself stock on account of the corporation's debt to him, we think he has no such authority. Even if he may be authorized to sell stock, no authority to take it in payment of his own account can be implied from that fact.

With regard to the payment of salaries the court said:

"The salary was voted at a meeting of the directors, at which only he and Symonds were present, when each was voted a salary. It is contended that such a vote was unauthorized. We think so. Directors have no authority to act for the corporation in matters in which they themselves are interested. They owe their whole duty to the corporation, and they are not to be permitted to act when duty conflicts with interest. They cannot serve themselves and the corporation at the same time. * * * For the same reason, directors cannot vote salaries to themselves

Nor can they vote a salary to one of their number, as president or secretary or treasurer, at a meeting where his presence is necessary to a quorum. And such votes, if passed, are voidable by the corporation, and if money has been paid it may be recovered back.'' p. 531.

In the case of *Fisher* v. *National Mortgage Loan Company*, 271 N.W. 433, a minority stockholder brought suit to require defendant-director to return funds and/or liberty bonds which were delivered in payment of debts owed to them by the corporation. The lower court held in favor of the defendants, upholding the right of the directors to pay their debt with the assets of the corporation. The corporation apealed. On appeal the court made a scholarly examination of the authorities and summarized the law with reference to the question of whether or not directors can dispose of assets to themselves or for the purpose of paying their own debts. The court summarized the law as follows:

> ''This case is principally the application of corportation law to the facts in evidence therein. An officer or director of a corporation occupies a fiduciary relation toward the corporation and its stockholders. (Citing cases) An officer or director of a corporation is not permitted without authority to divert corporate property to the payment of or securing a debt to himself. (Citing cases) In the Haywood case the rule is thus stated: 'Directors, officers, agents, and others like trustees cannot mortgage or convey to themselves any more than one can contract with himself. The idea that the same person constituting different identities of themselves by being called directors or officers of a corporation, so that, as directors or officers, they

can convey or mortgage to or contract with themselves as private persons, is in violation of common sense. (Citing cases) In the instant case, it is not a question of the justness or validity of the claims of the president. It is the law, as stated by the authorities, that an officer or director of a corporation cannot take the property of the corporation into his own hands to pay or secure a debt due himself from the corporation without authorization from the proper corporate authority. A lien on the property of the defendant corporation could only be fixed by agreement between the corporation and the president as claimant of the lien, or by some fixed rule of law. (Citing cases) It is also well established by our modern authorities that one cannot acquire a lien on property of another or of a corporation as a consequence of his own breach of duty." (Citing authority)

The court ordered the president of the company to repay to the corporation all of the money which he had received from the corporation in the form of cash and bonds, together with interest from the date he received the money and assets to date of judgment. The same relief should be granted the plaintiff corporation in this case against the defendants who participated in this wrongful transaction.

POINT III.

THE TRIAL COURT ERRED IN REFUSING TO HOLD THAT THE PLAINTIFFS WERE ENTITLED TO AN ACCOUNTING FROM THE DEFENDANTS AS A MATTER OF LAW.

Whenever there is undisputed evidence of the breach of duty on the part of a fiduciary in handling funds entrusted to him a court of equity will order the fiduciary to account. As has been heretofore pointed out, directors of a corporation are the trustees of its assets for the benefit of the stockholders and any action on their part to dispose of an asset to benefit themselves personally constitutes a breach of trust by those directors since they are bound to act only in the interest of the corporation and to take no action where their personal interests are inconsistent with the interest of the corporation or where by reason of their own interests in the transaction they cannot give to the stockholders the benefit of their independent judgment. The sale of corporate assets to pay their own debts is a fraud and a breach of trust and under such circumstances the corporation is entitled as a matter of law to an accounting from all participants in the transaction, including those who approved or acquiesced in the transaction even though they themselves did not benefit directly. In *Sorin v. Shahmoon Industries, Inc.*, 220 N.Y.S. 2d 60, minority stockholders sued the president and directors of the corporation demanding an accounting of their acts in expending corporate funds. The defendants demurred to the complaint on the ground that they had never received any funds into their possession which could be the subject matter of a trust and that they were not trustees in the sense that would require them to account to the corporation for authorizing the expenditure of funds from the corporate treasury. (It should be noted that in the Pioneer Carissa case the defendants did receive $130,000.00, which funds were never paid over to the corporation but which were disbursed directly by the president to the promoters and others without it ever reaching the corporate bank account.) The court, after considering whether or not a trust relationship existed in the *Sorin* case concluded that it did regardless of whether the defendant directors had actually received funds in their possession which could be the subject matter of a trust and held that the funds and assets of the corporation were in the hands of the directors in trust for the corporation and that the directors were obligated to account to the stockholders and the corporation for the handling of said funds. The court in its opinion said:

> "The defendants argue that the Jersawit case is inapplicable here because Shahmoon was not 'entrusted with property' but merely repaid for expenses incurred. In my view, the plaintiffs have the better of this dispute. All of the company funds were in effect entrusted to Shahmoon and the directors, and they were fiduciaries of the company with regard to their disbursement. It is of no consequence whether Shahmoon received the cash before he spent it or advanced it subject to repayment. He was spending corporate funds and is accountable for them, as are those directors who acquiesced in the out-go." p. 778.

In underscoring the high degree of fiduciary duty owed by the directors to the corporation and its stockholders the court brushed aside the defendant's argument that some of the items involved in the accounting were so small as to be de minimus and said:

"The defendants argue that the plaintiff's charges of wasted millions have degenerated to quibbles over paltry sums while the amount in question here is certainly not large in comparison to the company's volume of business, the duty of a fiduciary does not extend only to major matters for substantial amounts over which he has control. It extends to the last penny with which he is entrusted, even though any recovery warranted will be relatively minimal, the maximum of de minimis non curat lex is inapplicable. This is not a matter of principal, but of principle. The principle at stake here is simple and ancient: a fiduciary must account for the funds entrusted to his care — and that means 'all of such funds,' not 'some' or even 'most' of them. (c. f. in re Hamilton, 24 Misc. 2d 899, 195 N. Y. S. 2d 689.) A reference will be ordered at which Shahmoon will be held to account for these sums. * * *"

The defendant directors and promoters in this case have filed affidavits to the effect that the corporation owed them bona fide debts for salaries, expense accounts, and monies advanced to the corporation and for its benefit and they contend that they did not breach their duty by resolving to sell corporate assets to pay their own debts. In *Sage* v. *Culver, et al*, 41 N.E. 513, an identical situation was presented to the court. Minority stockholders sued the directors for an accounting. The defendant directors owned an overwhelming majority of the corporate stock. These minority stockholders contended that the directors had done the same thing that the defendants in the Pioneer Carissa case did, i. e., they resolved to pay corporate funds to themselves because of alleged loans made by them to the corporation. The defendant directors by way of answer denied that the stockholder plaintiffs were entitled to any accounting. The court in ruling that it was the duty of the defendants to account as a matter of law set out in classic language the law as it applies to officers, directors and promoters of a corporation who deal with corporate funds and assets for their own benefit.

> "When a trustee or the officer or director of a corporation deals with himself, as an individual, or in the character of trustee, director, or officer of another corporation, with respect to the funds, securities, or property of the corporation, the transaction is at least open to question by the corporation, or, in a proper case, by its stockholders; and the trustee is bound to explain the transaction, and show that the same was fair, and that no undue advantage has been taken by him in his position, for his own advantage, or the advantage of some other corporation in which he has an interest. When it can fairly be gathered from all the allegations of the complaint that the officers and directors of a corporation have made use of relations of trust and confidence in order to secure or promote some selfish interest, enough is then averred to set a court of equity in motion, and to require an answer from the defendants in regard to the fact. When it appears that the trustee or officer has violated the moral obligation to refrain from placing himself in relations which ordinarily produce a conflict between self interest and integrity, there is, in equity, a presumption against the transaction, which he is required to explain. (Citations) Parties holding relations of trust and confidence toward others, such as these defendants occupy towards the plaintiffs, cannot ordinarily afford to admit, by a demurrer, charges

though quite indefinite and uncertain, that they have made profit for themselves by means of transactions such as are fairly to be gathered from the averments of the complaint." p. 514.

Again in *Flight Equipment & Engineering Corporation v. Shetlon*, 103 S. 2d 615, an officer sued the corporation for money allegedly owed to him. The corporation filed a counterclaim alleging that the directors of the corporation had unlawfully resolved to pay to the officer a salary because the salary was in violation of the wage stabilization board regulations then in effect and asked the court to require the officer to account to the corporation for the salary money received. The officer contended that since the money was paid in good faith and with the approval of the board of directors even though it was in violation of the wage stabilization regulation there was no breach of trust and, therefore, the plaintiff was not entitled to an accounting as a matter of law. The court in holding the officer liable to account as a matter of law said:

> "A director or officer of the corporation is bound to account to the corporation for all monies and property which come into his hands by virtue of his official position, as well as for all sums of money or property which he has wrongfully accepted or withdrawn from the corporation. This moral and legal principal leads inevitably to requiring plaintiff to account fully for the sums withdrawn by him for expenses. Having failed to do so he must pay to defendant those sums for which he has failed to account." p. 625.

In this case the undisputed evidence shows that resolutions which the defendants rely upon as authority for paying out $130,000.00 of the corporate funds are a nullity because: (a) the salaries were authorized in violation of the express agreement not to authorize salaries until the corporate properties were on a paying basis, (b) there was never a disinterested quorum of directors to authorize the payment of the salaries, and (c) there was never a quorum of directors at all in existence to authorize the sale of the corporate assets and to pay the money over to the officers, directors and promoters of the company. As a consequence the plaintiff is entitled to an order of this court directing the defendants to account to the plaintiff for the funds received by them, including an accounting as to how they invested those funds and upon said accounting the court should impress a trust upon any assets or interest in assets acquired with these funds of the plaintiff corporation. In the event the assets acquired with these funds are insufficient to make the corporation whole as to the principal amount, together with interest, judgment should be entered against the defendants for the additional amount.

POINT IV.

THE STATUTE OF LIMITATIONS IS NOT A DEFENSE TO THIS ACTION.

The defendants in this action have raised the statute of limitations as a defense and cite 78-12-27 Utah Code Annotated, 1953, as the applicable statute. There are three reasons why this defense is unavailable to defendants. First, the applicable section is not 78-12-27 Utah Code Annotated, 1953, but 78-12-25, Utah Code Annotated, 1953. 78-12-27 applies to actions against directors or stockholders of a corporation to recover a penalty or forfeiture imposed, or to enforce a liability created by law. The basis for liability of the defendants in the instant case is not statutory liability but is liability arising out of the breach of fiduciary duties owed by the defendant-directors to the plaintiff corporation. In *Kamas Securities Company* v. *Taylor*, 226 P. 2d 111, the Kamas Securities Company sued Moses C. Taylor, its secretary, for wrongfully returning to his brother stock which his brother had pledged to secure promissory notes payable to the corporation. The complaint in that action charged the defendant, Taylor, with fraud in representing to the corporation that the notes were still secured by the pledged stock and as a result the corporation suffered loss. The defendant, Taylor, pleaded 104-2-24(3) (Code 1943) which is the three year statute of limitations applying to fraud actions and contain the same provision as 78-12-26. The court in that case held that notwithstanding the fact that the defendant, Taylor, was charged with fraud the action was actually for breach of his fiduciary duty to the corporation and, hence, this cause of action was governed by the four year statute of limitations provided in 104-2-30 (Code 1943) which is the same as our present 78-12-25 Utah Code Annotated, 1953. The court in so holding said:

> "It is true that the allegations of the amended complaint charged the defendant employed deceit,

that viewing the charge in its entirety it is clearly one of breach of fiduciary duty which would mean that the four years statute of limitations would be applicable, 104-2-30. The contention that action was barred by limitations was therefore properly overruled." p. 118.

Second, the defendants were in control of the corporation and maintained control of the corporation during the year 1958 and for some time thereafter and it is well established that the statute of limitations does not commence to run against wrongs of directors where the wrong-doers are in control of the corporation and fail or refuse to bring an action against themselves for and on behalf of the corporation.

Even if the defendant-appellants were correct in their contention that the three-year statute of limitations applies to this action the statute would not have run because of the fact that the directors of the corporation serving for the year commencing June 18, 1958 were Angelo M. Billis, Rulan J. Gill and Mrs. L[illegible] Gill, all of whom were participants in the breach of fiduciary duty involved in this action. It is well settled that under such circumstances the statute of limitations does not commence to run because the wrong doing directors could easily prevent the knowledge of the wrong doing from reaching the stockholders and presumably would have refused to bring an action to correct their own wrong doing. In *Beal* v. *Smith*, et al., 46 Cal. App. 271, 189 P. 341, the defendants were charged with conspiring to issue fraudulent securities while acting as officers and directors of the United Properties Company

The defendants were in control of the board of the company during the period in which they defrauded the company and for a substantial period thereafter. In an action brought by the corporation the defendants set up the statute of limitations as a bar. The court, in holding that the statute of limitations was not available because the corporation was dominated by the wrong doing directors, said:

> "But where as alleged here, the corporation and its board of directors were wholly under the domination of those who committed the original fraud, the corporation is deemed to be in the same position as an incompetent person or a minor without legal capacity either to know or to act in relation to the fraud so committed, and during such period of incapacity the statute of limitations does not run, at least against an innocent stockholder who is without knowledge of the fraud."

Third, the cause of action sued upon is a cause of action in quasi contract and for an accounting which involved the four-year statute of limitations. The defendants, having taken possession of the \$130,000.00 paid to the corporation by the buyers of the corporation's interest in the Rim Group of claims and the corporation never having received such funds, the defendants must account to the corporation for the funds received on behalf of the corporation and the corporation is entitled to enforce an implied contract to require the defendants to pay the money over to the corporation. This cause of action falls within 78-12-25, Utah Code Annotated, 1953, being an action upon a contract, obligation or liability not founded upon an instrument in writing and being an action for an accounting which falls in subdivision (2), i.e., "an action for relief not otherwise provided for by law." *Kimball v. McCornick*, 70 U. 189; 259 P. 313.

CONCLUSION

The trial court was correct in granting judgment against the defendants for the amount of the unlawful salaries paid to themselves, together with interest thereon. The trial court erred, however, in failing to make that judgment a joint and several judgment against all of the directors authorizing the illegal compensation and further erred in denying the plaintiff's motion for summary judgment for an accounting and in refusing to enter judgment against the defendants for the portions of the $130,000.00 which the defendants received and failed to pay over to the corporation.

Respectfully submitted,

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